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MODULE – 3



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Income of Other Persons Included in Assessee's Total Income

Learning Objectives

After studying this chapter, you would be able to understand -

- ◆ why clubbing provisions have been incorporated in the Act
- ◆ when clubbing provisions are attracted
- ◆ when income of the spouse is clubbed with the income of the individual
- ◆ when income of son's wife is clubbed in the hands of the individual.
- ◆ that minor's income has to be clubbed in the hands of the parent
- ◆ the nature of income of minor, in respect of which clubbing provisions are not attracted
- ◆ when income of HUF is clubbed in the hands of a member of the HUF.

1. Clubbing of Income – An Introduction

Under the Income-tax Act, 1961, an assessee is generally taxed in respect of his own income. However, there are certain cases where as assessee has to pay tax in respect of income of another person. The provisions for the same are contained in sections 60 to 65 of the Act. These provisions have been enacted to counteract the tendency on the part of the tax-payers to dispose of their property or transfer their income in such a way that their tax liability can be avoided or reduced.

For example, in the case of individuals, income-tax is levied on a slab system on the total income. The tax system is progressive i.e. as the income increases, the applicable rate of tax increases. Some taxpayers in the higher income bracket have a tendency to divert some portion of their income to their spouse, minor child etc. to minimize their tax burden. In order to prevent such tax avoidance, clubbing provisions have been incorporated in the Act, under which income arising to certain persons (like spouse, minor child etc.) have to be included in the income of the person who has diverted his income for the purpose of computing tax liability.

2. Transfer of income without transfer of asset [Section 60]

- (i) If any person transfers the income from any asset without transferring the asset itself, such income is to be included in the total income of the transferor.
- (ii) It is immaterial whether the transfer is revocable or irrevocable and whether it was made before the commencement of this Act or after its commencement.
- (iii) For example, Mr.A confers the right to receive rent in respect of his house property on his wife, Mrs.A, without transferring the house itself to her. In this case, the rent received by Mrs.A will be clubbed with the income of Mr.A.

3. Income arising from revocable transfer of assets [Section 61]

- (i) All income arising to any person by virtue of a revocable transfer of assets is to be included in the total income of the transferor.
- (ii) As per section 63, the transfer is deemed to be revocable if—
 - (a) it contains any provision for the retransfer, directly or indirectly, of the whole or any part of the income or assets to the transferor, or
 - (b) it gives, in any way to the transferor, a right to reassume power, directly or indirectly, over the whole or any part of the income or the assets.
- (iii) This clubbing provision will operate even if only part of income of the transferred asset had been applied for the benefit of the transferor. Once the transfer is revocable, the entire income from the transferred asset is includable in the total income of the transferor.

4. Exceptions where clubbing provisions are not attracted even in case of revocable transfer [Section 62]

Section 61 will not apply in the following two cases -

- (i) **Transfer not revocable during the life time of the beneficiary or the transferee** - If there is a transfer of asset which is not revocable during the life time of the transferee, the income from the transferred asset is not includable in the total income of the transferor provided the transferor derives no direct or indirect benefit from such income. If the transferor receives direct or indirect benefit from such income, such income is to be included in his total income even though the transfer may not be revocable during the life time of the transferee.
- (ii) **Transfer made before April 1, 1961 and not revocable for a period exceeding six years** - Income arising from the transfer of an asset before 1.4.61, which was not revocable for a period exceeding six years, is not includable in the total income of the transferor provided the transferor does not derive direct or indirect benefit from such income.

In both the above cases, as and when the power to revoke the transfer arises, the income arising by virtue of such transfer will be included in the total income of the transferor.

5. Clubbing of income arising to spouse [Section 64(1)(ii)]

5.1 Income by way of remuneration from a concern in which the individual has substantial interest

- (i) In computing the total income of any individual, all such income which arises, directly or indirectly, to the spouse of such individual by way of salary, commission, fees or any other form of remuneration, whether in cash or in kind, from a concern in which such individual has a substantial interest shall be included.
- (ii) However, this provision does not apply where the spouse of the said individual possesses technical or professional qualifications and the income to the spouse is solely attributable to the application of his/her technical or professional knowledge or experience. In such an event, the income arising to such spouse is to be assessed in his/her hands.
- (iii) Where both husband and wife have substantial interest in a concern and both are in receipt of income by way of salary etc. from the said concern, such income will be includible in the hands of that spouse, whose total income, excluding such income is higher.
- (iv) Where any such income is once included in the total income of either spouse, income arising in the succeeding year shall not be included in the total income of the other spouse unless the Assessing Officer is satisfied, after giving that spouse an opportunity of being heard, that it is necessary to do so.
- (v) An individual shall be deemed to have substantial interest in a concern under the following circumstances -

- (a) If the concern is a company, equity shares carrying not less than 20% of the voting power are, at any time during the previous year, owned beneficially by such person or partly by such person and partly by one or more of his relatives.
- (b) In any other case, if such person is entitled, or such person and one or more of his relatives are entitled in the aggregate, at any time during the previous year, to not less than 20% of the profits of such concern.

The term 'relative' in relation to an individual means the husband, wife, brother or sister or any lineal ascendant or descendant of that individual.

Illustration 1

Mr. A is an employee of X Ltd. and he has 25% shares of that company. His salary is ₹ 50,000 p.m. Mrs. A is working as a computer software programmer in X Ltd. at a salary of ₹ 30,000 p.m. She is, however, not qualified for the job. Compute the gross total income of Mr. A and Mrs. A for the A.Y.2015-16, assuming that they do not have any other income.

Solution

Mr. A is an employee of X Ltd and has 25% shares of X Ltd i.e. a substantial interest in the company. His wife is working in the same company without any professional qualifications for the same. Thus, by virtue of the clubbing provisions of the Act, the salary received by Mrs. A from X Ltd. will be clubbed in the hands of Mr. A.

5.4 Income-tax

Computation of Gross total income of Mr. A

Particulars	₹
Salary received by Mr. A ($\text{₹ } 50,000 \times 12$)	6,00,000
Salary received by Mrs. A ($\text{₹ } 30,000 \times 12$)	3,60,000
Gross total income	9,60,000

The gross total income of Mrs. A is nil.

Illustration 2

Will your answer be different if Mrs. A was qualified for the job?

Solution

If Mrs. A possesses professional qualifications for the job, then the clubbing provisions shall not be applicable.

Gross total income of Mr. A = Salary received by Mr. A [$\text{₹ } 50,000 \times 12$] = ₹ 6,00,000

Gross total income of Mrs. A = Salary received by Mrs. A [$\text{₹ } 30,000 \times 12$] = ₹ 3,60,000

Illustration 3

Mr. B is an employee of Y Ltd. and has substantial interest in the company. His salary is ₹ 20,000 p.m. Mrs. B is also working in Y Ltd. at a salary of ₹ 12,000 p.m. without any qualifications. Mr. B also receives ₹ 30,000 as interest on securities. Mrs. B owns a house property which she has let out. Rent received from tenants is ₹ 6000 p.m. Compute the gross total income of Mr. B and Mrs. B for the A.Y.2015-16.

Solution

Since Mrs. B is not professionally qualified for the job, the clubbing provisions shall be applicable.

Computation of Gross total income of Mr. B

Particulars	₹
Income from Salary	
Salary received by Mr. B ($\text{₹ } 20,000 \times 12$)	2,40,000
Salary received by Mrs. B ($\text{₹ } 12,000 \times 12$)	1,44,000
	3,84,000
Income from other sources	
Interest on securities	30,000
	4,14,000

Computation of Gross total income of Mrs. B

Particulars	₹	₹
Income from Salary [clubbed in the hands of Mr. B]		Nil

Income from house property			
Gross Annual Value [₹ 6,000 × 12]	72,000		
Less: Municipal taxes paid	-		
Net Annual Value (NAV)	72,000		
Less: Deductions under section 24			
- 30% of NAV i.e., 30% of ₹ 72,000	21,600		
- Interest on loan	-	50,400	
Gross total income		50,400	

5.2 Income arising to the spouse from an asset transferred without adequate consideration [Section 64(1)(iv)]

- (i) Where there is a transfer of an asset (other than house property), directly or indirectly, from one spouse to the other, otherwise than for adequate consideration or in connection with an agreement to live apart, any income arising to the transferee from the transferred asset, either directly or indirectly, shall be included in the total income of the transferor.
- (ii) In the case of transfer of house property, the provisions are contained in section 27. If an individual transfers a house property to his spouse, without adequate consideration or otherwise than in connection with an agreement to live apart, the transferor shall be deemed to be the owner of the house property and its annual value will be taxed in his hands.
- (iii) It may be noted that any income from the accretion of the transferred asset is not to be clubbed with the income of the transferor.
- (iv) The income arising on transferred assets alone have to be clubbed. However, income earned by investing such income (arising from transferred asset) cannot be clubbed.
- (v) It is also to be noted that natural love and affection do not constitute adequate consideration. Therefore, where an asset is transferred without adequate consideration, the income from such asset will be clubbed in the hands of the transferor.
- (vi) Where the assets transferred, directly or indirectly, by an individual to his spouse are invested by the transferee in the business, proportionate income arising from such investment is to be included in the total income of the transferor. If the investment is in the nature of contribution of capital, proportionate interest on capital will be clubbed with the income of the transferor. Such proportion has to be computed by taking into account the value of the aforesaid investment as on the first day of the previous year to the total investment in the business by the transferee as on that day.

6. Transfer of assets for the benefit of spouse [Section 64(1)(vii)]

All income arising directly or indirectly to any persons or association of persons, from the assets transferred, directly or indirectly, without adequate consideration is includible in the income of the transferor to the extent such income is used by the transferee for the immediate or deferred benefit of the transferor's spouse.

7. Income arising to son's wife from the assets transferred without adequate consideration by the father-in-law or mother-in-law [Section 64(1)(vi)]

- (i) Where an asset is transferred, directly or indirectly, by an individual to his or her son's wife without adequate consideration, the income from such asset is to be included in the total income of the transferor.
- (ii) For this purpose, where the assets transferred directly or indirectly by an individual to his son's wife are invested by the transferee in the business, proportionate income arising from such investment is to be included in the total income of the transferor. If the investment is in the nature of contribution of capital, the proportionate interest on capital will be clubbed with the income of the transferor. Such proportion has to be computed by taking into account the value of the aforesaid investment as on the first day of the previous year to the total investment in the business by the transferee as on that day.

8. Transfer of assets for the benefit of son's wife [Section 64(1)(viii)]

All income arising directly or indirectly, to any person or association of persons from the assets transferred, directly or indirectly, without adequate consideration will be included in the total income of the transferor to the extent such income is used by the transferee for the immediate or deferred benefit of the transferor's son's wife.

9. Clubbing of minor's income [Section 64(1A)]

- (i) All income of a minor is to be included in the income of his parent.
- (ii) However, the income derived by the minor from manual work or from any activity involving his skill, talent or specialised knowledge or experience will not be included in the income of his parent.
- (iii) The income of the minor will be included in the income of that parent, whose total income is greater.
- (iv) Once clubbing of minor's income is done with that of one parent, it will continue to be clubbed with that parent only, in subsequent years. The Assessing Officer, may, however, club the minor's income with that of the other parent, if, after giving the other parent an opportunity to be heard, he is satisfied that it is necessary to do so.
- (v) Where the marriage of the parents does not subsist, the income of the minor will be includable in the income of that parent who maintains the minor child in the relevant previous year.
- (vi) Section 10(32) provides that where the income of an individual includes the income of his minor child, the individual shall be entitled to exemption of such income subject to a maximum of ₹ 1,500 per child. This provision is to provide relief to the individuals in whose total income, the income of the minor child is included.
- (vii) However, the income of a minor child from suffering from any disability of the nature specified in section 80U shall not be included in the hands of the parent but shall be assessed

in the hands of the child.

(viii) It may be noted that the clubbing provisions are attracted even in respect of income of minor married daughter.

Illustration 4

Mr. A has three minor children – two twin daughters and one son. Income of the twin daughters is ₹ 2,000 p.a. each and that of the son is ₹ 1,200 p.a. Compute the income, in respect of minor children, to be clubbed in the hands of Mr. A.

Solution

Taxable income, in respect of minor children, in the hands of Mr. A is

Particulars	₹	₹
Twin minor daughters [₹ 2,000 × 2]	₹ 4,000	
Less: Exempt under section 10(32) [₹ 1,500 × 2]	₹ 3,000	₹ 1,000
Minor son	₹ 1,200	
Less: Exempt under section 10(32)	₹ 1,200	Nil
Income to be clubbed in the hands of Mr.A		₹ 1,000

10. Cross Transfers

In the case of cross transfers also (e.g., A making gift of ₹ 50,000 to the wife of his brother B for the purchase of a house by her and a simultaneous gift by B to A's minor son of shares in a foreign company worth ₹ 50,000 owned by him), the income from the assets transferred would be assessed in the hands of the deemed transferor if the transfers are so intimately connected as to form part of a single transaction, and each transfer constitutes consideration for the other by being mutual or otherwise. Thus, in the instant case, the transfers have been made by A and B to persons who are not their spouse or minor child so as to circumvent the provisions of this section, showing that such transfers constituted consideration for each other.

The Supreme Court, in case of *CIT v. Keshavji Morarji* [1967] 66 ITR 142, observed that if two transactions are inter-connected and are parts of the same transaction in such a way that it can be said that the circuitous method was adopted as a device to evade tax, the implication of clubbing provisions would be attracted. Accordingly, the income arising to Mrs. B from the house property should be included in the total income of B and the dividend from shares transferred to A's minor son would be taxable in the hands of A. This is because A and B are the indirect transferors to their minor child and spouse, respectively, of income-yielding assets, so as to reduce their burden of taxation.

11. Conversion of self-acquired property into the property of a Hindu Undivided Family [Section 64(2)]

Section 64(2) deals with the case of conversion of self-acquired property into property of a Hindu undivided family.

(i) Where an individual, who is a member of the HUF, converts at any time after 31-12-1969, his individual property into property of the HUF of which he is a member or throws such property into the common stock of the family or otherwise transfers such individual property, directly or indirectly, to the family otherwise than for adequate consideration, the income from such property shall continue to be included in the total income of the individual.

(ii) Where the converted property has been partitioned, either by way of total or partial partition, the income derived from such converted property as is received by the spouse on partition will be deemed to arise to the spouse from assets transferred indirectly by the individual to the spouse and consequently, such income shall also be included in the total income of the individual who effected the conversion of such property.

(iii) Where income from the converted property is included in the total income of an individual under section 64(2), it will be excluded from the total income of the family or, as the case may be, of the spouse of the individual.

12. Income includes loss

It is significant to note that as per the *Explanation 2* to section 64, 'income' would include 'loss'. Accordingly, where the specified income to be included in the total income of the individual is a loss, such loss will be taken into account while computing the total income of the individual. It is significant to note that this *Explanation* applies to clubbing provisions under both sections 64(1) and 64(2).

13. Distinction between section 61 and section 64

It may be noted that the main distinction between the two sections is that section 61 applies only to a revocable transfer made by any person while section 64 applies to revocable as well as irrevocable transfers made only by individuals.

14. Liability of person in respect of income included in the income of another person [Section 65]

Sections 61 to 64 provide for clubbing of income of one person in the hands of the other in circumstances specified therein. However, service of notice of demand (in respect of tax on such income) may be made upon the person to whom such asset is transferred (i.e. the transferee). In such a case, the transferee is liable to pay that portion of tax levied on the transferor which is attributable to the income so clubbed.